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No. 97-877

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1997

ELIZABETH R. COCKRELL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit

REPLY BRIEF FOR PETITIONER

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QUESTION PRESENTED

The issue to be decided is whether and in what circumstances a fair reading of Section 6013(e)(1)(C) of the Internal Revenue Code imposes an implied duty of inquiry for a non-culpable person to qualify as an innocent spouse; and, if under any circumstances the duty is imposed, whether such duty exists under circumstances where such inquiry would be unreasonable or futile.

STATEMENT OF JURISDICTION

The judgment of the Court of Appeals was entered on June 24, 1997. On September 2, 1997, Justice Ginsburg extended the time to file a petition for a writ of certiorari to and including November 21, 1997. The petition for a writ of certiorari was filed on November 21, 1997. Respondent's request for an extension of time to file a reply brief was granted by the Clerk of this Court on December 24, 1997 extending the time to file a response to and including January 28, 1998. On January 28, 1998, a Brief for the Respondent in Opposition ("Resp. Br.") was filed and an amicus brief was filed by Richard C.E. Beck, Esq., National Taxpayer's Union, Women's Bar Association of the State of New York and The National Organization for Women Foundation. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATEMENT OF THE CASE

This reply fully concurs with the points addressed in the Amicus Brief. This reply will specifically and exclusively address the portions of Respondent's Brief which are inaccurate or misleading. Each such inaccurate or misleading statement will be addressed in the order found in Respondent's Brief.

ARGUMENT

Respondent is incorrect in asserting that since each case contains different facts, there is no conflict in the circuits. In particular, Respondent incorrectly asserts that the decision in *Reser v. Commissioner*, 112 F.3d 1258 (5th Cir. 1997) does not conflict with the case at bar. (Resp. Br. at 9-12). In *Reser*, an attorney at law claimed innocent spouse relief from a large deduction of $257,354. There, despite her advanced education, the Fifth Circuit ruled that the taxpayer was an innocent spouse even though she did not inquire concerning the propriety of the deduction. The court reasoned that such inquiry would have been futile and

therefore held that "[n]either the court nor the law will penalize Reser for failing to perform the hollow act of asking questions, the answers to which would have provided no new or different information."

These facts are indistinguishable from those in the case at bar (except to the extent that Petitioner only held a bachelor's degree in English while Ms. Reser was a licensed attorney). In the facts of this case, since her husband himself was a promoter of the tax shelter, certainly a request of him as to the propriety of the deductions stemming therefrom would not have yielded any new or different information.

Next, Respondent argues that the existence of large deductions on the returns should have alerted Petitioner that "something highly unusual must have occurred with respect to their financial situation." (Resp. Br. at 11). Even if that were true, as noted in *Reser*, the duty of inquiry is obviated if such inquiry would prove futile. The existence of a tax shelter on a return in 1980 or 1981 was far from unusual. As pointed out in *Friedman v. Commissioner*, 53 F.3d 523, 531 (2d Cir. 1995):

> In the early 1980s it was a matter of common knowledge that wily investors could find legal ways and means of attaining spectacular tax benefits through cunning investment strategies. See, e.g. Deborah Rankin, *Personal Finance: The Continued Appeal of Tax Shelters*, N.Y. Times, Aug. 8, 1982, § 3 at 13 . . . Mere knowledge that the spouse has invested in a tax shelter resulting in substantial tax savings is accordingly, without more, insufficient to establish constructive knowledge of a substantial understatement. (Internal citations omitted).

Respondent also points to Petitioner's college degree as evidence that she was educated and therefore held to a higher standard. (Resp. Br. at 2, 9). This argument was squarely rejected

in *Resser v. Commissioner*, 74 F.3d 1528, 1537 (7th Cir. 1996) which held that "petitioner's liberal arts degrees did not enable her to be familiar with the business and financial concepts needed to question financial decisions." (Citing *Robertson v. Commissioner*, 63 T.C.M. (CCH) 1822, 1826, 1992 WL 3724 (1992)). *Resser*, 74 F.3d at 1537, therefore held that

> [t]he record will not support a determination that a reasonably prudent taxpayer with Mrs. Resser's education could be expected to know that the losses claimed in the 1982 tax return, based on highly complex financial transactions, contained a substantial understatement.

Respondent ignores the case of *Guth v. Commissioner*, 897 F.2d 441 (9th Cir. 1990) which held that no duty was triggered even where an innocent spouse

> was aware of the bare existence of the transactions leading to the deductions [and] was apparently not aware of anything unusual about them. It is this subjective awareness on the part of the taxpayer of something odd or unusual about the circumstances leading to the understatement that triggers the duty to inquire.

Respondent also ignores *Resser* which held that a duty of inquiry is only triggered under a subjective test of whether "a reasonably prudent taxpayer in her position [would] be led to question the legitimacy of the deduction." *Resser*, 74 F.3d at 1541; *Erdahl v. Commissioner*, 930 F.2d 585, 591 (8th Cir. 1991); *Guth v. Commissioner*, 897 F.2d 441 445 (9th Cir. 1990). The court in *Resser* concluded that the wife did not have a duty to inquire even though she did not read the return before signing it.

Respondent argues, in a footnote, that since legislation is pending in Congress that could alter the scope of "innocent spouse"

status, this case's prospective importance is uncertain. (Resp. Br. 12 at n.4) As pointed out in Petitioner's Petition for Certiorari, the current proposal passed by the U.S. House of Representatives and being considered by the U.S. Senate does not affect the prospective effect of a decision by this Court. The issues to be decided — the meaning of the "did not know and had no reason to know" language contained in § 6013(e)(1)(C) and whether such language imposes a duty of inquiry and in what circumstances — will not be effected by the legislation since no change to § 6013(e)(1)(C) is contemplated by H.R. 2292 (Internal Revenue Service Restructuring and Reform Act of 1997).

Finally, it is not at all surprising that Respondent fails to mention the horrific Internal Revenue Service abuses inflicted against Petitioner. Respondent clearly hopes to pretend the abuses did not occur while attempting to hold Petitioner to an exceedingly high standard found in some cases such as *Kistner* and *Stevens* while downplaying the more taxpayer-friendly legal principles found in cases such as *Reser*, *Guth* and *Resser*. This Court should not countenance such unfair tactics.

CONCLUSION

For the reasons set forth in this reply brief and in the Petition for Certiorari, the Petition for Certiorari should be granted.

Respectfully submitted,

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